

Date of Hearing: June 22, 2010

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT AND THE
ECONOMY

V. Manuel Perez, Chair

SB 1484 (Wright) – As Amended: June 14, 2010

SENATE VOTE: Not relevant

SUBJECT: Public contracts

SUMMARY: Prohibits the Department of General Services (DGS) and other state entities from entering into bundled contracts for goods, that exclude certified small businesses (CSBs) or Disabled Veteran Business Enterprises (DVBEs), as defined. Specifically, this bill:

- 1) Prohibits DGS and other state entities authorized to enter into contracts from engaging in the bundling of contracts, as defined, for goods that exclude CSBs, including microbusinesses, or DVBEs.
- 2) Defines "bundling of contracts" to mean the use of a solicitation for a single contract, or a multiple award contract, to satisfy two or more requirements for goods, the result of which restricts competition due to any one of the following:
 - a) The diversity, size, or specialized nature of the elements of the performance;
 - b) The aggregate dollar value of the anticipated award;
 - c) The geographical dispersion of the contract performance sites; or
 - d) Restrictive contract requirements or other similar procurement factor that limits the ability of a responsible small business to compete or otherwise participate as a prime contractor in the procurement process.
- 3) Provides that state contracting with a CSB, microbusiness or DVBE does not count toward the state's 25% CSB or the 3% DVBE procurement goals if the contract is with a prime contractor that subcontracts with a CSB, microbusiness or DVBE.

EXISTING LAW:

- 1) Declares state policy that CSBs receive a fair portion of the total purchases and contracts, or subcontracts, for state goods, services, information technology, and construction.
- 2) Designates DGS to administer the state Small Business Procurement and Contract Act (Small Business Act), including, but not limited to, a small business certification process and a streamlined procurement process for state contracts under \$250,000, which is exempt from advertising, bidding, and protest provisions in the State Contract Act.
- 3) Establishes, through Executive Order (EO), a 25% annual CSB participation goal for DGS and all state entities. There have been three EOs; EO D-37-01, EO S-02-6 and EO S-22-06.

- 4) Establishes a 25% CSB participation goal for all contracts financed with the proceeds of the infrastructure-related bond acts of 2006.
- 5) Declares that in order to facilitate the participation of CSBs and microbusiness in the provision of goods, information technology, and services to the state, and the construction of state facilities, that department and agencies that enter into those contracts shall to do the following:
 - a) Establish a preference for bids made by CSBs and microbusinesses for the award of state procurement contracts of 5% where solicitations are made either on the basis of lowest responsible dollar bid, or on the basis of highest score, considering factors in addition to price. A single bid preference is limited to \$50,000 and the combined value of preferences granted may not exceed \$250,000.
 - b) Permit non-small businesses that subcontract at least 25% of their contracts with CSB to also qualify for the small business bidder's preference.
 - c) Require state agencies to give special consideration to CSBs by reducing the experience required and/or reducing the level of inventory normally required in order facilitate CBSs participation in state contracts.
 - d) Requires state agencies to make awards, whenever feasible, to CSBs for each project bid within their prequalification rating. This may be accomplished by dividing major projects into subprojects, so as to allow a CSBs or microbusinesses to qualify to bid on these subprojects.
- 6) Defines the following:
 - a) A CSB is an independently owned, not dominant in its field of operation, domiciled in California, employing 100 or fewer employees, and earning \$10 million or less in average annual gross revenues for the three previous years;
 - b) A Microbusiness is a small business that has average annual gross receipts of \$250,000 or less during the previous three years or is a manufacturer with 25 or fewer employees; and
 - c) A DVBE is a business entity that is at least 51% owned or controlled by one or more disabled veterans.

FISCAL EFFECT: Unknown

COMMENTS:

- 1) Author's purpose: SB 1484 is being introduced in order to increase the ability of Certified Small Business, Microbusiness and DVBEs participation in contracting with the state as direct contractors in contracts for goods. This bill will conform California practices to long lasting federal law and regulations that prevent the bundling of contracts that exclude CSBs and DVBEs from direct participation as the prime contractor.

The unbundling of state contracts will significantly reduce costs to the state, increase the amount of CSB, microbusiness and DVBE participation and provide more jobs to economy. Rather than simply increasing competitively bid contract solicitations or mandatory contractors where CSBs or DVBEs could realistically compete with large businesses, the DGS instead began to solicit bids for very large, "bundled" or prime vendor contracts that are awarded to large national or multinational companies whose revenues derived from these contracts leave the state. These prime vendor contracts are made up of existing contracts that historically have been awarded primarily to small subcontractors. Thus, this practice sharply reduces or even eliminates direct state contracts with the CSBs and DVBEs.

Contracts that are bundled are usually awarded to larger companies at a much higher price than if these contracts had been broken up into smaller contracts. Breaking up the contracts in this fashion would enable large and small companies to bid competitively against each other for the state's business.

For these reasons, federal law and procurement regulations have for years prohibited the bundling of federal contracts that have the effect of restricting or excluding small business participation in the federal procurement.

- 2) Importance of small business participation: Over the years, California has been concerned with ensuring CSBs have a fair and equitable opportunity to successfully bid and receive state contracts. Since 1983 the state has provided CSBs with a 5% bid preference, a streamlined procurement process for small size contracts, as well as, special considerations during the bidding process.

In latter years, a 25% CSB and a 3% DVBE procurement participation goal was added as another means for the state to enhance its commitment to CSBs and DVBEs. Three EOs have been released throughout the years, with the most recent EO released in 2006, EO S-02-06. This last EO also included a process whereby departments that fail to meet their annual goals are required to prepare a correction action in collaboration with the both the Small Business Advocate and DGS.

- 3) What is contract bundling? The federal Small Business Reauthorization Act of 1997 defines contract bundling as "consolidating two or more procurement requirements for goods or services previously provided or performed under separate, smaller contracts into a solicitation of offers for a single contract that is unlikely to be suitable for award to a small business concern".

The federal government, since its work in the late 1990s, has developed more expertise in addressing the negative impacts and developing policies that more effectively limit the bundling of contracts. Additional details on the federal governments activities are described below. SB 1484 is modeled after the federal law.

- 4) Why are contracts bundled? There are a number of reasons agencies began to bundle contracts. The most common explanation provided by agencies is that bundled contracts are the result of staff reductions and increased demands to streamline the purchasing processes. In the past, it was suggested that bundling contracts would be more cost efficient than soliciting multiple contracts. Evidence now, however, suggests that large bundled contracts have led, in some cases, to higher prices being charged overall.

As an example, in the case of the Office Depot contract, it took someone from outside the state government process to notice the price inconsistencies and inform DGS that the state may have been overcharged. To DGS's credit, they immediately conducted an audit of the contract and confirmed problems. In 2008, the Office Depot agreed to repay \$2.5 million to the state as a result of the audit. In reviewing the DGS audit, it appeared there was inadequate oversight of the bundled contract. State agencies may need to be asked required to codify in advance of issuing the solicitation that they have adequate staff to properly oversee large-size procurement contracts.

The federal government has been concerned for over a decade with making sure that CSBs receive a fair and equitable opportunity to bid on and obtain federal contracts. In 2002, the federal Small Business Advocate's Office of Advocacy published a report "The Impact of Contract Bundling on Small Business FY 1992-99". According to the report, for every 100 bundled contracts, 106 individual contracts were no longer available to small businesses. For every \$100 awarded on a "bundled" contract, there is a \$33 decrease to small business. Because bundled contracts run longer and encompass a greater scope of products or services, competition is reduced in terms of frequency and the number of bid opportunities. Data indicates that although the overall money spent in contracting with small business has remained relatively constant, there has been a sharp decline in the number of new contracts being awarded to small business.

- 5) Federal Unbundling Actions: In March 2002, then President Bush asked the Small Business Administration to prepare a strategy for the unbundling of federal contracts. The report "A Strategy for Increasing Federal Contracting Opportunities for Small Business," was released in October 2002 by the Office of Management and Budget and the Office of Federal Procurement Policy. The strategy holds agencies accountable for eliminating unnecessary contract bundling and mitigating the effects of necessary contract bundling. The following recommended actions are included in the strategy to help agencies increase contracting opportunities for small business.
- a) Senior management are required to be held accountable for eliminating unnecessary contract bundling and mitigating the effects of necessary and justified contract bundling;
 - b) Multiple award contracts are required to be specially reviewed;
 - c) A contracting agency that proposes the use of a bundled contract must first try to identify an alternative acquisition strategy and to provide written justification when alternatives involving less bundling are not used; and
 - d) Small business teams and joint ventures are encouraged, as a means to mitigate the effects of contract bundling.

A complete list of recommendations and actions can be found in contract bundling strategy at http://www.whitehouse.gov/omb/procurement/contract_bundling_oct2002.pdf.

- 6) California Small Business: California's dominance in many economic areas is based, in part, on the significant role small businesses play in the state's \$1.8 trillion economy. Businesses

with fewer than 100 employees comprise more than 99% of all businesses and are responsible for employing more than 57% of all workers in the state.

As an example, small- and medium-sized businesses are crucial to the state's international competitiveness and are an important means for dispersing the positive economic impacts of trade within the California economy. Of the over 55,878 companies that exported goods from California in 2007, 95% were small- and medium-sized enterprises (SME) with fewer than 500 employees. These SMEs generated two-fifths (44%) of California's exports in 2007. Nationally, SMEs generated well above 30% of total exports.

Historically, small businesses have functioned as economic engines, especially in challenging economic times. During the nation's economic downturn from 1999 to 2003, microenterprises (businesses with less than five employees) created 318,183 new jobs or 77% of all employment growth, while larger businesses with more than 50 employees lost over 444,000 jobs. From 2000 to 2001, microenterprises created 62,731 jobs in the state, accounting for nearly 64% of all new employment growth. Unfortunately during the current recession, small business have been especially hard hit with small business bankruptcies up 81% for the 12 months ending September 2009, as compared to the same period in the previous year. Nationally, bankruptcy filings were up 44%, according to Equifax Inc.

Because of their importance in the state economy, small business issues have been a particular focus of the Assembly Committee on Jobs, Economic Development and the Economy (JEDE) for the past several years. In March 2009, JEDE produced a state economic recovery strategy that included several key recommendations on the needs of small business, including helping small businesses meet their short term capital needs. In May 2009, JEDE held a special hearing to learn more about how the recession was impacting small businesses and in October, JEDE's review of the California Enterprise Zone Program included a panel on how the program responds to needs of small business.

- 7) The Small Business Act: The Small Business Act, administered through DGS, was implemented more than 30 years ago to establish a small business preference within the state's procurement process for the purpose of increasing the number of contracts between the state and small businesses.

In 1989, a DVBE component was established with the Small Business Act to address the special needs of disabled veterans seeking rehabilitation and training through entrepreneurship and to recognize the sacrifices of Californians disabled during military service. Under the provisions of the DVBE program, each state agency is required, in awarding contracts throughout the year, to honor California's disabled veterans by taking all practical actions necessary to meet or exceed an annual 3% DVBE participation goal.

Since 2001, there have been four EOs and a number of statutory advancements made to strengthen the Small Business Act, including SB 115 (Flores), Chapter 451, Statutes of 2005, which required DGS to establish a DVBE incentive program for state contracts; and AB 761 (Coto), Chapter 611, Statutes of 2007, which specifically codified the 25% small business participation goal for contracts related to revenues expended from the 2006 infrastructure bonds.

Despite the longstanding existence of the Small Business Act, statutory upgrades, and EOs, the state's success in obtaining small business and DVBE participation goals in state procurement contracts has been inconsistent.

For only the second time since the 25% small business participation target was established in 2001 through executive order, DGS reported that the state achieved its small business target by awarding 28.31%, or \$2.65 billion, of the value of all contracts to small businesses in the 2006-07 fiscal year. This represents a \$1.3 billion increase in contracts from 2005-06. The state did not, however, achieve its 3% DVBE participation goal in 2006-07, as only 2.8% of contract dollars, \$186 million, was awarded in contracts including DVBE participation.

- 8) Proposed amendments: Staff understands the author has agreed to the following amendments:
- a) Delete language which prohibits counting, subcontracts with CSBs, and DVBEs as part of the 25% small business and 3% DVBE procurement goals; and
 - b) Add a five year sunset.

In addition, the committee may wish to consider if there is a need to have, under certain limited circumstances, a process in place for the approval of bundled contracts. The small Business Advocate may be an appropriate third party to review and determine appropriateness of prospective bundled contracts for compliance with a limited set of criteria.

- 9) Related legislation: Related legislation includes the following:
- a) AB 2708 (Bill Berryhill) DGS Contracts: This bill prohibits the Department of General Services (DGS) and the directors of other state departments or agencies that enter into contracts from engaging in the bundling of contracts and other requirements as specified. This is pending in Assembly Jobs, Economic Development and the Economy Committee.
 - b) AB 31 (Price) Small Business Public Contracts: This bill made several key changes to state procurement procedures, including increasing the maximum contract threshold amount for awards to a small business or DVBE, under a specific streamlined procurement process, from \$100,000 to \$250,000. Further, the bill requires contractors that made contract commitments to include small business or DVBE participation to report the final percentage of the contract actually paid to these entities. Status: Signed by the Governor, Chapter 202, Statutes of 2009.
 - c) AB 177 (Ruskin and V. Manuel Pérez) - Penalties under the Small Business Act: This bill increases and conforms penalties for persons who falsely engage in activities relating to the Small Business Procurement and Contract Act, including small businesses, microbusinesses, and disabled veteran-owned business enterprises. Status: The bill is pending in Senate Veteran Affairs, set for hearing on June 22, 2010.
 - d) AB 309 (Price) – Small Business Participation: This bill would have required the establishment of a 25% small business participation goal for all state entities and directs the Department of General Services (DGS) to monitor each agency's progress in

meeting this goal. Status: Held on suspense in Assembly Appropriations Committee in 2009.

- e) AB 2330 (Arambula) - Small Business Costs Study: This bill requires the OSBA to commission a study of the costs of state regulations on small businesses that is parallel to the study on the impact of regulatory costs on small firms conducted by the federal Small Business Administration. The OSBA is required to make recommendations on how to reduce the cost of existing and future regulations on small businesses while achieving the same policy and regulatory objectives. This bill also convenes a small business advisory committee to provide advice based on the study and recommendations. Status: Signed by the Governor, Chapter 232, Statutes of 2006.
- f) SB 1108 (Price) 25 Percent Small Business Goal: This bill makes three enhancements to the Small Business Act including authorizing the implementation of a 25% small business procurement goal, the development of specific administrative procedures for implementing the small business preference and requiring the state to take a more active role in promoting certification of small businesses. Status: Pending in Assembly, Jobs, Economic Development and the Economy, set for hearing on June 22, 2010.

REGISTERED SUPPORT / OPPOSITION:

Support

Adolph Foods Inc.
Basic Logistics
Bruce Logistics Inc.
California Black Chamber of Commerce (sponsor)
California Small Business Association
Coalition of Small and Disabled Veteran Businesses (sponsor)
Maintex, Inc.
Ostrow & Associates
Ritchie Trucking Service Inc.
San Joaquin Distributors, Inc.
Small Business California
Titus Enterprises, Inc.
The Langlois Company

Opposition

None received

Analysis Prepared by: Mercedes Flores / J., E.D. & E. / (916) 319-2090